

CDIAC

**CALIFORNIA
DEBT AND
INVESTMENT
ADVISORY
COMMISSION**

SESSION ONE:

DEBT CAPACITY AND AFFORDABILITY

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Debt Capacity and Affordability

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Sources of Restrictions

- Restrictions Imposed by Law
- Restrictions Imposed by Contract
- Restrictions Imposed by Policy Makers

Restrictions Imposed by Law

- Proposition 13 (1978)
- Proposition 218 (1996)
- Proposition 26 (2010)

Restrictions Imposed by Contract

- Additional Bonds Test (ABT)
- Also known as coverage requirement
- Restrictions on senior lien obligations
- Typically, no restrictions on subordinate lien obligations
- Determined by Investors, Rating Agencies, Bond Insurers

Restrictions Imposed by Policy Makers

- Reserve Policy
- Investment Policy (will determine rate of return on investments)
- Maximum Tax Level (i.e. Goals and Policies for Community Facilities District)

General Obligations Bonds

- California – Voter Approved (No Limitation on Levy Amount)
- Direct and Overlapping Debt
- Total Effective Tax Rate

Lease Revenue Bonds/COPs

- General fund obligation subject to abatement
- Surplus is needed for taking on additional obligations unless existing obligation is about to expire
- Otherwise, need additional revenue sources (i.e. sales tax measure/parcel tax)
- Asset Transfer

Revenue Bonds

- Enterprise
- Tax Allocation Bonds (only cared about capacity as debt was needed to receive tax increment)
- Special Tax Revenues (Mello-Roos/CFD)

ABT/Coverage

- Coverage = Net Revenues divided by Maximum Annual Debt Service (MADS)
- ABT requires coverage of a certain percentage
- How do you calculate Net Revenues (customer deposits, depreciation and other non-cashflow expenses are excluded)
- How do you calculate Debt Service (variable rate debt or notes can complicate matters)

In the Real World...

Debt Capacity and Affordability – the Market Perspective

October 23, 2013

Oakland Marriott City Center

Tony Hughes

Managing Director, Western Region Manager

Barclays

Debt Capacity and Affordability

1. Bond structures
2. Underwriter risk exposure
3. How do internal credit committees, underwriters and investors evaluate debt capacity and affordability?

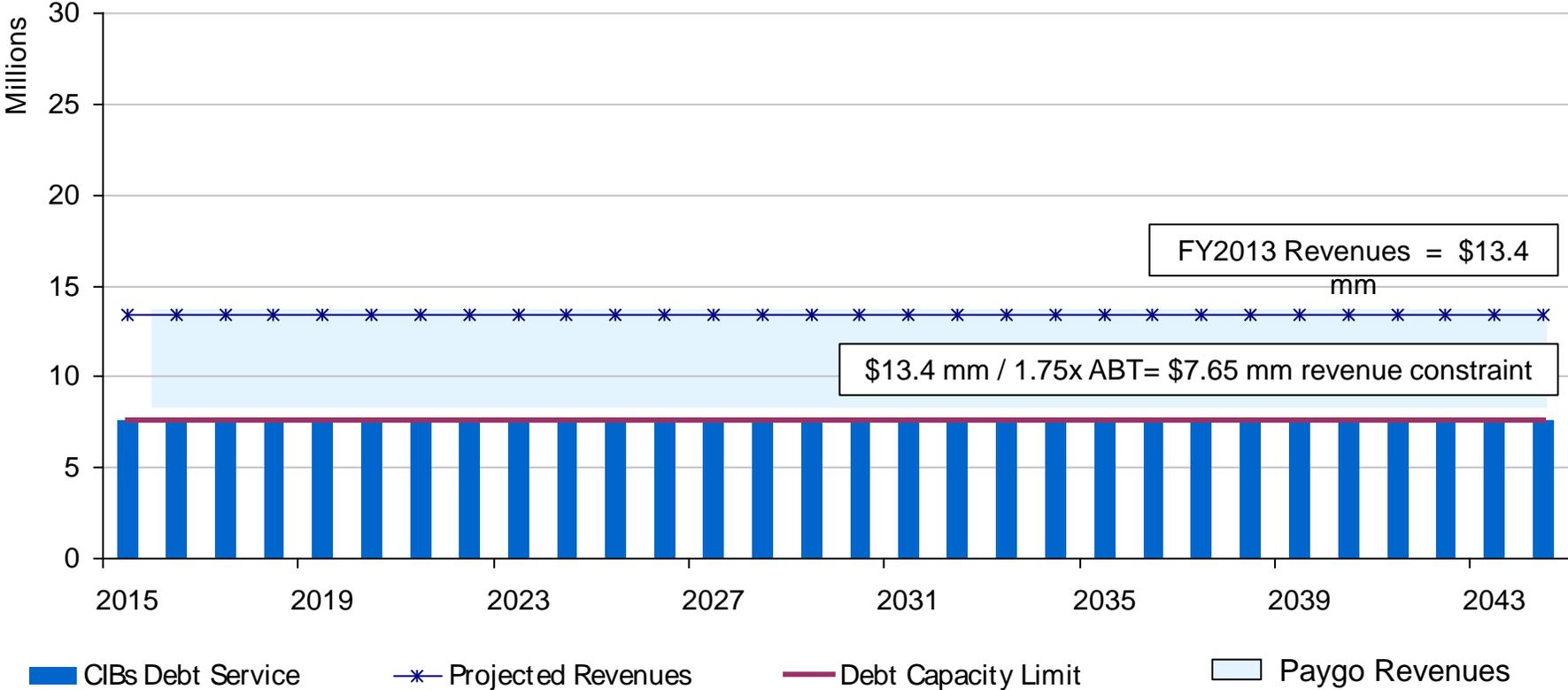
Bond Structures

Differing revenue streams and coverage requirements will impact how much issuers can borrow and at what cost

Historical ABT Test

Usually seen with water revenue bond issuers and sales tax revenue bond issuers; under this test, issuers will generally structure level debt service payments over life of bonds.

Level Debt Service with Historical ABT

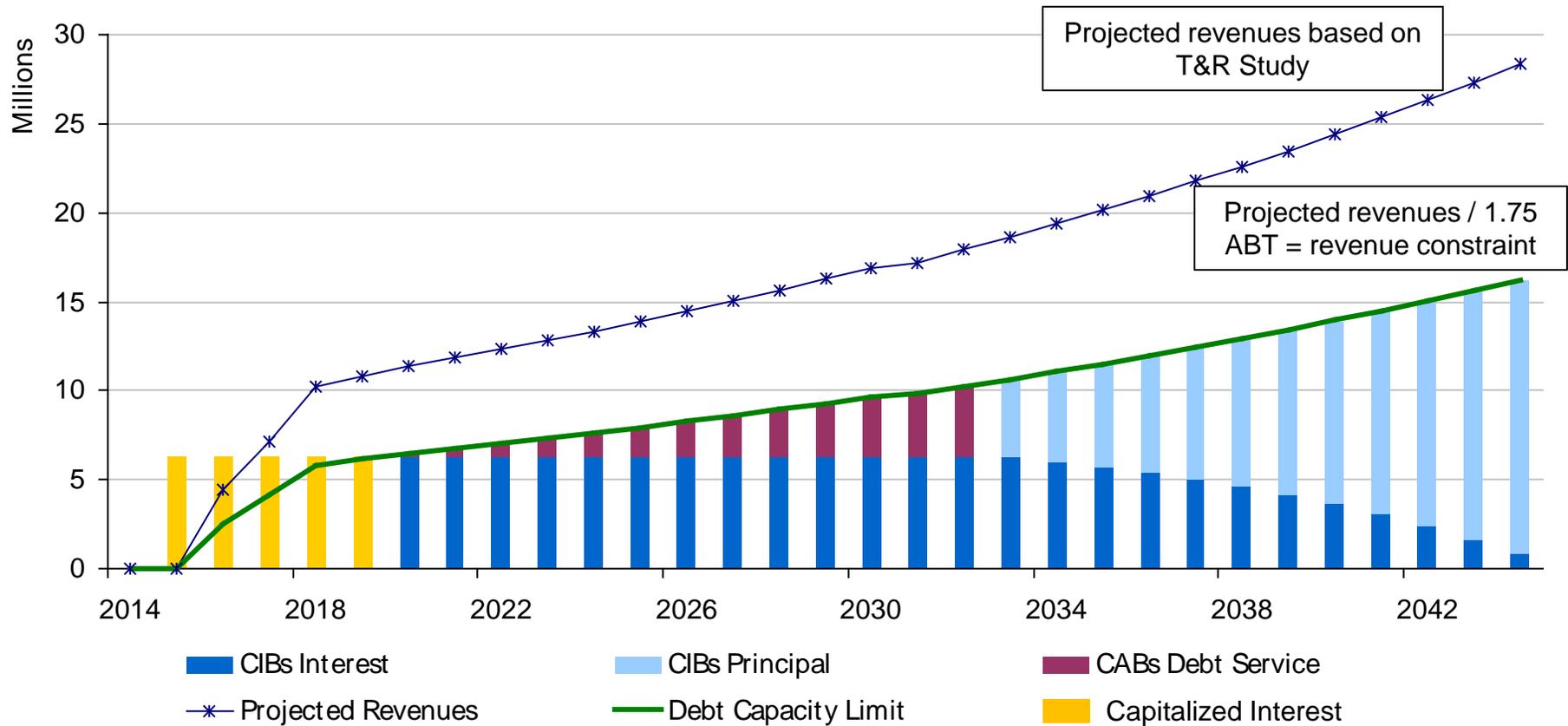


Par	\$120 million	Average Annual D/S	\$7.6 million
ABT	1.75x	Total D/S	\$230 million
All-in-TIC	5.59%	Average Life	19 years

Projected ABT Test

Often seen with toll revenue bond issuers; this requirement allows issuers to shape ascending debt service over time

Increasing Revenues with Projected ABT



Par	\$120 million	Average Annual D/S	\$10 million
ABT	1.75x	Total D/S	\$300 million
All-in-TIC	5.82%	Average Life	25 years

Other Structuring Considerations

When structuring bonds, how do bankers and financial advisors view affordability?

- Beyond meeting coverage requirements and satisfying legal and policy restrictions, there are several other items to consider:
 - Near term budgetary needs?
 - Structure or restructure debt to ease burden in early years
 - Future capital needs? Other unknowns?
 - Incorporate flexibility in structure to issue new debt or refund bonds later
 - call options, structuring options
 - Uncertain construction schedule?
 - Commercial paper to reduce negative arbitrage
 - Construction period with little to no revenues?
 - Capitalize interest

What risks do broker-dealers take on?

- Reputational Risk
- Pricing risk
- Closing risk
- Secondary market maker in bonds post-pricing

Broker-Dealers and Investors

How do broker-dealers and investors evaluate the affordability of an issuer's borrowing program?

- Analysis of projected revenues and of risks associated with achieving these revenues
- Revenue raising ability
- Fiscal governance
- Sensitivity analyses
- Surrounding economy
- Future borrowing needs and potential for additional parity debt

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